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BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268-0001

ANNUAL COMPLIANCE REPORT, 2011	Docket No. ACR2011

COMMENTS OF
THE NATIONAL POSTAL POLICY COUNCIL
(February 3, 2012)

The National Postal Policy Council ("NPPC") respectfully submits these comments on the Postal Service's Annual Compliance Report for Fiscal Year 2011 ("*ACR*"), filed December 29, 2011. The ACR shows that the volume of the First-Class Presort Letters/Cards product continued to decline in FY2011, with a year-over-year decrease of 1.7 billion pieces, or 3.7 percent. Because the First-Class Presort product is the Postal Service's most profitable and largest product, these "continued presort volume declines create significant financial concerns." *ACR* at 17.

The annual compliance review process provides an appropriate opportunity for the Postal Service and Commission to recognize and begin to address some of the issues affecting First-Class Presort Mail. In particular, NPPC submits that:

- Rates for the First-Class Automation and Presort Letters and Cards mail product greatly exceeded attributable costs and paid an excessive – and increasing – cost coverage which cannot be sustained consistently with the Section 3622(b)(1) & (b)(8) objectives to maximize incentives to reduce costs and maintain a just and reasonable rate schedule;

- The Postal Service's ACR correctly places responsibility for the excessive cost coverage on current worksharing discount policies, including the legally and factually flawed conclusion that the Presort product is merely a workshared derivative of (the much smaller volume) Single-Piece Mail product and also the failure to adopt a benchmark that accurately reflects the cost characteristics of Presort mail;

- First-Class Presort Letters and Cards generally satisfied applicable discount standards, and the Postal Service is taking action where appropriate;
- The continuing cross-subsidy of Standard Mail flats by Standard Mail letters must be addressed in a way that reduces the burden on letters, while taking into account the possible counterproductive consequences for mailers systemwide from potentially abrupt reductions in Standard flats volumes; and
- The reported service quality performance for First-Class Presort Mail again failed to meet the Postal Service's own published service standard, a frustrating performance for the Postal Service's most profitable product.

I. THE COST COVERAGE FOR THE FIRST-CLASS PRESORT LETTERS AND CARDS PRODUCT IS EXCESSIVE

In its comments on the Postal Service's Annual Compliance Report for Fiscal Year 2010, NPPC observed that First-Class Presort Mail has persistently paid extremely high per-piece contributions to institutional costs and excessive cost coverages over many years. *Comments of the National Postal Policy Council*, Docket No. ACR2010 at 4-5 (February 2, 2011). The Postal Service's *ACR* in this proceeding shows that this situation worsened in FY 2011.

The following table presents the unit contributions and cost coverages for Presort Letters and Cards in the years since the Commission recognized Presort Mail as a separate product in the Mail Classification Schedule after ratemaking was revamped by the Postal Accountability and Enhancements Act.

	Unit Cost (cents)	Unit Revenue (cents)	Unit Contribution (cents)	Cost Coverage
FY 2008	11.023	33.023	22.000	299.6%
FY 2009	11.704	34.152	22.448	291.8%
FY 2010	11.679	34.739	23.060	297.4
FY 2011	11.6	34.8	23.2	298.8

Annual Compliance Determination, FY 2008 at Table III-2 (March 30, 2009); *Annual Compliance Determination,* FY 2009 at Table VII-1 (March 29, 2010 as corrected); Annual Compliance Determination, FY 2010 at Table VII-1 (March 29, 2011); *ACR* FY 2011 at Table 1.[1]

As this table shows, the unit contribution of the First-Class Mail Presort product has increased every year since the PAEA, and that Presort unit revenues are ***triple*** attributable costs, averaging 34.8 cents per piece while costing only 11.6 cents. By contrast, the higher cost of Single-Piece mail (27.8 cents per piece) more than offsets its higher average postage (44.8 cents), resulting in a unit contribution of only 17 cents on a cost coverage of 161.19 – much less than the 23.2 cents per piece contribution and 298.8 cost coverage of Presort Letters/Cards. *See ACR*, Table 1 (page 16).

[1] The Commission approved the establishment of Presort Letters/Cards as a distinct product in 2007. Order No. 43, *Regulations Establishing a System of Ratemaking*, Docket No. RM2007-1 (Oct. 29, 2007).

In its comments last year, NPPC stated:

> There will be a point at which a persistently high cost coverage for commercial bulk First-Class letters can no longer be "just and reasonable" under Section 3622(b)(8) of the Postal Accountability and Enhancements Act. That time may be at hand where the volume of the product facing the exorbitant cost coverage are declining year after year.
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> At noted above, commercial bulk First-Class letters bear the highest cost coverage in the system. This high markup (as noted, double the attributable costs of the product) contributes to the decline in volume of this product. While historically the Postal Service has maintained high cost coverages for commercial First-Class letters, such a strategy is increasingly unsustainable in an age where less costly electronic alternatives are readily available.

Comments of the National Postal Policy Council, Docket No. ACR2010 at 4-5. NPPC further observed that these exceptionally high cost coverages are unsustainable as volumes decline, that they are driving Presort mailers to alternatives, and that market-dominant product price regulation exists to protect mailers in such situations.

In that proceeding, as the Postal Service states: "In the FY 2010 ACD, the Commission noted presort customers' concern that the presort cost coverages were too high and could soon be not 'just and reasonable.' FY 2010 ACD, at 85. . . . . Unfortunately, in FY 2011, the difference between the unit contributions of presorted First-Class Mail letters and single-piece First-Class Mail Letters increased (from 5.2 cents in FY 2010 to 6.1 cents in FY 2011)." *ACR*, n.21 at 50.

The consequences of these persistently excessive rates on Presort Mail were as could be expected in FY2011. Presort letter volumes continued their steady decline, driven to electronic alternatives as postage rates ate into tight budgets. And Presort cards volume fell by more than 6 percent compared to FY2010.[2] Although the Postal Service's introduction of new pricing for two-ounce letters on January 22 may help slightly, this will be offset by the crushing increases imposed on Presort cards – including 10 percent at the 5-digit category -- that will drive the cost coverage upwards still more and accelerate efforts by those mailers to convert to alternatives.

Equally as importantly, the Postal Service's *ACR* goes on to point out that existing policies ensure that Presort mail will continue to pay excessive prices: "Under the Commission's workshare rules, this difference in unit contribution is almost certain to grow. Thus, the Commission's current interpretation and application of the workshare provision appears to be on a collision course with the clear statutory objective of a just and reasonable rate schedule." *Id*.

NPPC agrees. What perpetuates the inequitable burden placed on Presort Mail is the Commission's continuing to regard First-Class Presort mail as a worksharing derivative of Single-Piece Mail. *Order Adopting Analytical Principles Regarding Workshare Discount Methodology*, Docket No. RM2010-13 (Sept. 14, 2010) (Order No. 536). That linkage also means that Presort prices are, essentially, set in a mechanical process once the Single-Piece stamp price is set, leaving no room for the Postal Service to exercise its pricing flexibility to address Presort mail market

[2] USPS Final Revenue, Pieces, and Weight Report for Fiscal Year 2011 (Market Dominant Products) at 1 (Nov. 25, 2011).

considerations. NPPC believes that interpretation to be incorrect as a matter of law[3] and contrary to the statutory objective of maximizing incentives to reduce costs.[4]

Moreover, the problem has been compounded for many years by the use of a "benchmark"– Bulk Metered Mail ("BMM") – that utterly fails to account for many of the factors that cause Presort mail to cost the Postal Service much less to handle than Single-Piece mail. The failure of the BMM benchmark to capture the costs saved by Presort mail has resulted in Presort Mail long having paid excessive rates.

The Commission has already correctly held that the BMM concept – a fictitious construct – is "obsolete" and no longer valid. Order No. 536 at 2, 3, & 40. Unfortunately, no final order has issued in Docket No. RM2010-13, the proceeding established to identify a new benchmark.[5] Thus, even if it were appropriate to have a worksharing benchmark between Single-Piece and Presort mail, which it is not, *no* benchmark is currently in place, much less one that fully reflects the costs avoided by Presort Mail.

Unfortunately, the persistently excessive prices for the First-Class Presort mail product will not be corrected until either the Commission simply abandons altogether

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[3] NPPC's position is that the Commission's ruling that a worksharing relationship exists between Single-Piece mail and Automation and Presorted mail is incorrect as a matter of law. The Postal Service's petition for review of the Commission's conclusion to that effect in Order No. 536 was dismissed as not ripe by the U.S. Court of Appeals for the District of Columbia Circuit. *United States Postal Service v. Postal Regulatory Commission*, Docket No. 10-1324 (mandate issued Oct. 21, 2011). NPPC intervened in that proceeding in support of the Postal Service.

[4] 39 U.S.C. §3622(b)(1).

[5] Comments were filed by various parties on February 18 and reply comments on April 4, 2011.

the notion that Presort mail is in a worksharing relationship with Single-Piece mail or a realistic benchmark is established that enables the Postal Service to recognize fully the cost differences. As a step towards giving Presort mailers necessary relief and to ensure ongoing compliance by Presort rates with Sections 3622(b)(1) and (b)(8), the Commission should complete its workshare rulemaking and adopt a realistic, accurate benchmark.

II. THE POSTAL SERVICE'S APPROACH TO FIRST-CLASS PRESORT DISCOUNTS IN THE *ACR* SHOULD BE APPROVED

Section 3622(e) requires, with certain exceptions not applicable here, that worksharing discounts should not exceed 100 percent of the estimated costs avoided. Given that the *ACR* reports costs for a fiscal year that concluded more than four months ago, and that new prices are now in effect, the Postal Service reasonably and rationally applies this provision by adjusting the passthroughs of avoided costs on an ongoing basis. *See ACR* at 51. The *ACR* provides no basis upon which the Commission should modify Presort rates.

A preliminary issue is the relationship between Single-Piece and Presort rates. As noted above, NPPC believes that the Commission's interpretation that Section 3622(e) applies to that relationship is contrary to law and is a major factor in the excessive contribution to overhead costs paid by Presort Mailers. Furthermore, as noted above, the Commission has recognized that the benchmark used in years past -- BMM – is benchmark is obsolete and provides no accurate basis for assessing discounts today.

The Postal Service concedes that there is no real reason to use BMM:

> Given the Commission's position in Order No. 536 that there is a worksharing relationship between single-piece letters and presort letters but that the Bulk Meter Mail (BMM) benchmark is no longer valid, the calculations of the Automation Mixed AADC Letters and Nonautomation Presort Letters passthroughs are no longer meaningful.

ACR at 52. Nonetheless, it has done so: "the Postal Service is continuing to provide passthrough calculations for Automation Mixed AADC Letters and Nonautomation Presort Letters using BMM Letters as a benchmark." *Id*.

The Postal Service's continued use of the admittedly obsolete BMM construct as a guide, both here and in its recent adjustments of market-dominant prices, is perplexing. Much more accurate signals would have resulted had the Postal Service at least compared the Automation discounts to the costs of metered mail – which it proposed as a new benchmark in its comments in Docket No. RM2010-13. An even better approach would have to been to use metered mail including collection costs, which as NPPC and others showed was the measure that best corresponds with the *only empirical evidence* regarding what mail might convert to worksharing.[6]

For the purposes of this proceeding, it suffices that even by the obsolete BMM measure, the passthrough between Single-Piece and Presort do not exceed 100

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[6] *Joint Comments of the American Bankers Association, The Bank of America Corporation, The Direct Marketing Association, Discover Financial Services, The Major Mailers Association, The National Association of Presort Mailers, and the National Postal Policy Council*, Docket No. RM2010-13 (Feb. 18, 2011); *Reply Comments of the American Bankers Association, The Bank of America Corporation, The Direct Marketing Association, Discover Financial Services, The Major Mailers Association, The National Association of Presort Mailers, and the National Postal Policy Council*, Docket No. RM2010-13 (April 4, 2011).

percent. However, were any measure of metered mail used as the guide, the passthroughs would be seen as well less than 100 percent.

Within Presort letters, where Section 3622(e) does apply, the Postal Service's ACR identifies two passthroughs that exceed 100 percent – Automation AADC letters (104.8 percent) and 5-digit Automation letters (104.2 percent). ACR at 52. In both cases the issue arises because of changes in the estimated costs avoided. Three discounts in Presort cards have passthroughs that exceed the estimated costs avoided. In each case, the costs avoided shrank compared to the previous year.

By now, the Commission has had sufficient experience with this process to understand that minor fluctuations in estimated costs avoided occur on almost an annual basis. Matters are further complicated by the fact that the rates under evaluation in the *ACR* are no longer in effect, having been superseded by new rates that took effect on January 22, 2012, and the costs are from a fiscal year that ended more than four months ago and therefore are inapplicable to current rates. Thus, a minor disparity in a prior year's ACR process – without much more – does not provide a sound basis for adjusting current rates.

Here, the Postal Service notes that in each of these five instances it has either addressed the matter in the recent price adjustments or will do so in the future. And, since the costs avoided are for the period October 1, 2010 through September 30, 2011, and the new rates will be in effect from January 2012 for presumably at least a year, it is quite possible that increases in postal costs will cause the avoided costs to increase as well.

III. THE CROSS-SUBSIDY OF STANDARD FLATS MUST BE ADDRESSED TO ALLEVIATE THE BURDEN ON STANDARD LETTERS

NPPC members also make use of Standard letter mail for marketing purposes. Those members are overpaying for letters in Standard Mail as well as in First-Class Presort Mail due to the continuing cross-subsidy of Standard flats by Standard letters and other Standard Mail products. In FY 2011, as the Postal Service acknowledges, the Standard flats product once again failed to cover even its attributable costs, while Standard letters did so and more with a cost coverage of 184. *ACR* at 28.

The Postal Service and the Commission well know that the cross-subsidy of Standard flats has been a recurring concern for a number of years, and has recently given rise to litigation between the Postal Service and the Commission. At the same time, the inability of Standard flats to cover their attributable costs has meant that Standard letters have been overcharged to the detriment of mail volumes. It should be noted that all Standard Mail has a multiplier effect – NPPC member Standard letters often result in new accounts, which in turn generate statements and payment mail -- so there is no particular reason to single one category of mail out for consistent preferred rates.

At the same time, NPPC understands the danger of rate shock and remembers that the last increase in catalog rates to address this problem directly was followed by a very substantial volume decline that affected the entire mailstream and, as a result, affected all mailers. The Postal Service and the Commission therefore should continue to work to rectify this unreasonable burden on Standard letters, addressing the current cross-subsidy in a manner consistent with the 39 U.S.C. §3622(b)(2) objective of stable rates and cognizant of the potential systemwide consequences.

IV. DESPITE BEING THE POSTAL SERVICE'S MOST PROFITABLE PRODUCT, FIRST-CLASS PRESORT LETTERS CONTINUE TO RECEIVE SUBSTANDARD SERVICE

The ACR reports that the Postal Service missed its service target for Presort Letters and cards for Overnight, Two-Day, and Three-Day deliveries. *ACR* at USPS-FY11-29 at 5. This means that, for yet another year, the Postal Service's most profitable customers have received substandard service. The combination of subpar service with excessive prices is a discouraging way for the Postal Service to treat its most valuable customers. Remarkably, Single-Piece letters received better service, considering that that product is characterized by cost-raising factors such as many colored envelopes and handwritten addresses, etc.

NPPC understands that the Presort service is measured not by an external source, but by the Intelligent Mail Accuracy and Performance System, and that this system is only now really getting underway with the most Full Service Intelligent Mail mailings not being eligible for measurement until the last quarter. *Id*. at 2. NPPC hopes that the new measurement system will show improved service performance in next year's compliance report, although the data collection remains limited to only Full Service Intelligent mailers.

Finally, NPPC notes that in Docket No. N2012-1, the Postal Service is seeking an advisory opinion on reduced service standards for First-Class Mail in connection with its network rationalization proposal. NPPC recognizes the Postal Service's need to rationalize its mail processing and transportation networks to reflect current and future volume trends, and in principle supports these efforts to reduce costs.

However, there are many questions that NPPC and its members have about the implications and implementation of the network rationalization and reduced service standards proposals. Without addressing at this time the specifics of those proposals, NPPC notes that in its comments of October 21, 2011, responding to the Advance Notice of Proposed Rulemaking on these matters published by Postal Service, it raised a significant number of those questions.[7] NPPC continues to examine the proposals in order to determine their impact on the mailings of its members.

That said, however, the effect of the service standards changes is not to improve the actual quality of service, but to move the goal lines in a way that may result in improved scores. This would constitute improved service on paper, but not in reality. The Commission should be mindful of the effects of the possible service standard changes in assessing service performance in future years if the service standards are revised as proposed.

V. CONCLUSION

The National Postal Policy Council respectfully urges the Commission to find that First-Class Presort rates are consistent with statutory requirements, but that a just

[7] Letter from Arthur B. Sackler to Manager, Industry Engagement and Outreach, U.S. Postal Service (Oct. 21, 2011) (commenting on proposed rules published at 76 *Fed. Reg*. 58433).

and reasonable schedule should require a reduced cost coverage for Presort mail. NPPC urges the Commission to act promptly in Docket No. RM2010-13 to adopt Metered Mail, as proposed jointly by NPPC and others in that proceeding, as a realistic benchmark. The Commission and Postal Service should also address the cross-subsidy of Standard flats in a measured way that reduces the burden on Standard letters.

Respectfully submitted,

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